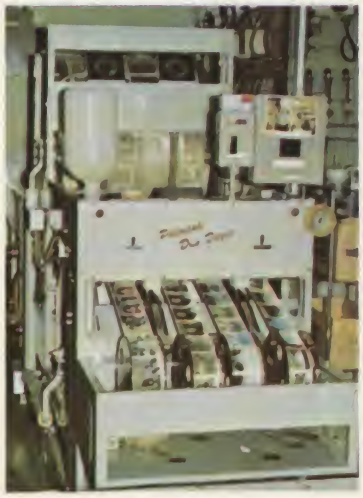
Gray Drug Stores, Inc.

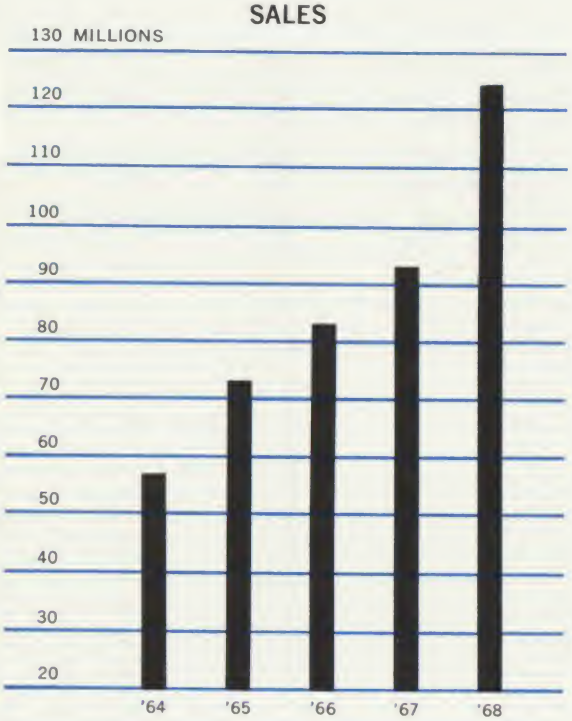
1968 Annual Report

CLEVELAND PUBLIC LIBRARY
BUSINESS INF. DEP.
CORPORATION FILE

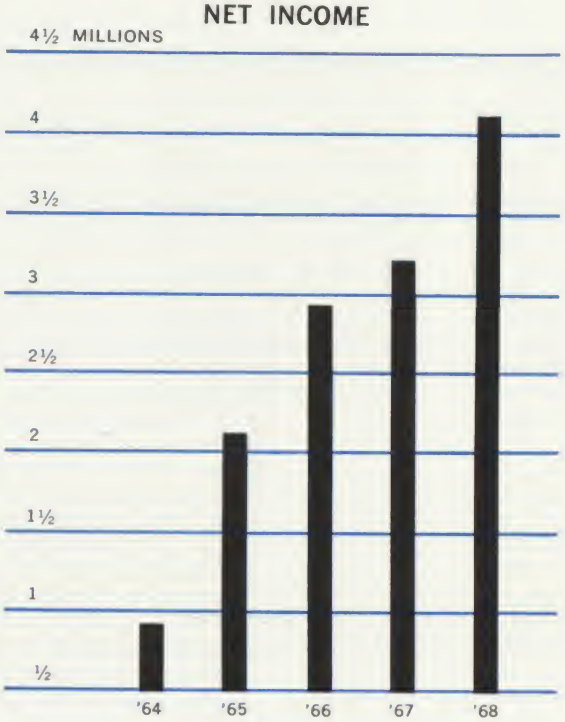
Million rolls of color and black-and-white film a year can be processed by automatic equipment in new 30,000 square foot plant just opened by our Superior Photo Division in Cleveland to handle rapidly rising volume of processing work turned in at photo departments of all our retail stores, such as the department shown at lower left.



SALES



NET INCOME



HIGHLIGHTS OF OPERATIONS

Fiscal Years Ended June 30	1968	1967	1966
Net Sales	$124,899,300	$93,598,735	$83,352,705
Net Income	$ 4,193,766	$ 3,256,894	$ 2,912,432
Net Income Per Share	$ 2.52	$ 2.01	$ 1.79
Dividends Per Share	$ 1.00	$ .74	$ .59
Working Capital	$ 21,434,044	$15,077,210	$13,786,368
Current Ratio	2.4 to 1	2.32 to 1	2.19 to 1
Shareholders Equity	$ 25,380,661	$22,099,435	$20,045,091

STORES AND LEASED DEPARTMENTS

Years Ended June 30	Conventional Drug Stores	Discount Drug Stores	Leased Dept's in Stores of Other Retailers	Department Stores	Total Outlets Excluding Intra-company Leased Dept's	Leased Dept's Operated by Our Own Divisions in Stores of Other Divisions	Stores Remodeled and Enlarged
1964	106	13	32		151		30
1965	109	17	17	6	149	9	39
1966	114	16	26	7	163	10	32
1967	113	22	25	8	168	19	30
1968	113	22	21	22	178	25	28

Letter to Shareholders

C. W. Evans, Chairman

Jerome A. Weinberger, President

Sales of Gray Drug Stores, Inc., totaled $124,899,300 during the fiscal year ended June 30, 1968, an increase of 33.4 per cent over the preceding year.

This was the 18th consecutive year in which sales set a new record, and new projects already well under way assure continuing major expansion during the current year.

Net income before taxes was $7,698,566, up 26.5 per cent over the preceding year. Net income after taxes, including a deduction of $176,231 or 11 cents a share as a result of the new Federal surtax, was $4,193,766 or $2.52 a share. This is also an all-time high, and is an increase of 28.8 per cent over earnings of $3,256,894 or $2.01 a share a year ago.

Fiscal 1968 figures reflect the acquisition of Bargain City Stores, and earnings per share for 1967 are adjusted for the 5-for-4 stock split effective in November, 1967.

Division Operations

Gray Drug continues to strengthen its position as one of the nation's principal drug chains and as a large operator of junior department stores.

Combined profit of our drug divisions was up 15.9 per cent during the past year on an 8.6 per cent increase in sales to a total of $79,733,615.

Direct sales of our department store divisions totaled $45,165,685, and sales of leased departments operating in these stores were $52,837,440, so that total sales in our 22 junior department stores now are near the $100,000,000 a year mark. Leased department sales are not included in our own statements, except for the increasing number of such departments operated by our own divisions, but rental from lessees adds to our profits.

Sales of our Rink's Department Stores Division climbed 27.2 per cent to $25,634,078, and the new Bargain City Stores Division added $19,531,607 to our volume in its first year as a part of Gray Drug.

Rink's profit margins decreased somewhat last year. It was affected by large union wage increases linked to the increase in national minimums, by expenses related to the opening of a new warehouse, and by intense competition. At Bargain City, we incurred large expenses related to its acquisition, such as the cost of bringing its employees into our overall corporate pension, insurance and hospitalization programs and tying its operations into our own systems and procedures.

Major Expansion Under Way

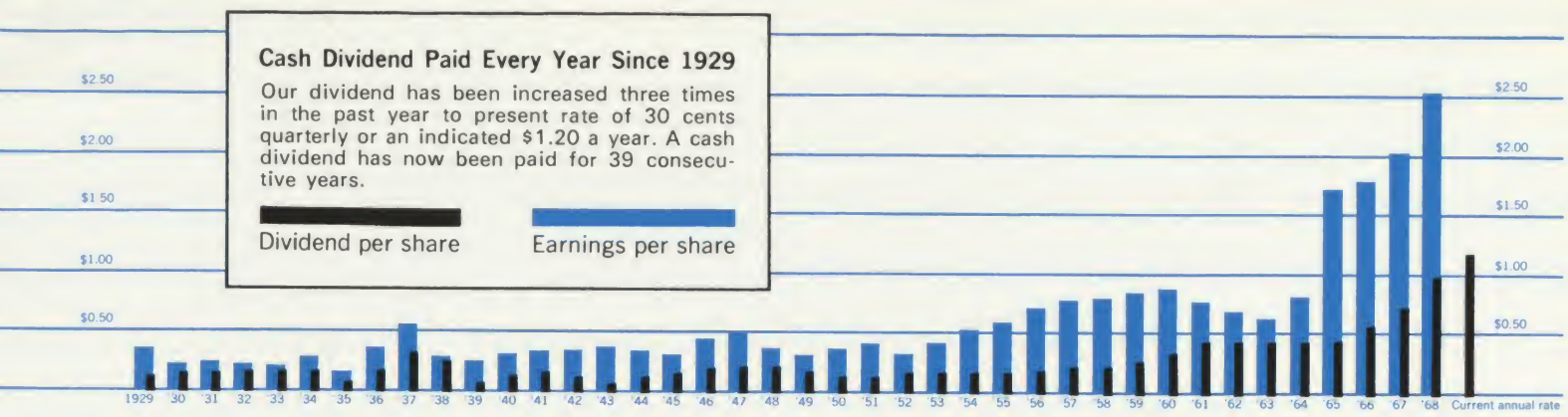
A large expansion program affecting all of our divisions will add substantially to sales during the current fiscal year.

We are opening seven conventional drug stores during the fiscal year ending June 30, 1969, mainly in large regional shopping centers. This is the largest number of conventional drug stores we have added for a number of years, and seven others are already on the schedule beyond fiscal 1969.

Six discount drug openings are presently planned, with negotiations under way for a number of others.

Two new Bargain City stores of about 100,000 square feet each are now nearing completion, one in Toledo and the other in Marion, Ohio. They will replace small existing stores, and are expected to add $4,000,000 or more to sales on an annual basis. Negotiations are in progress for two other locations.

Bargain City since June has bought the leased appliance departments in eight of its stores, and is



Adolph Weinberger (right), founder and chairman of the executive committee of Gray Drug, is shown with Robert W. Haack, president of the New York Stock Exchange, at ceremonies marking the listing of our shares on the Exchange beginning last January.

starting appliance departments in three more stores.

Rink's during recent months has purchased or opened seven women's wear departments and six men's wear departments in Bargain City stores.

Rink's also is remodeling its large Evendale store and adding 25,000 square feet to its Milford store, both in the Greater Cincinnati area.

In Cleveland, we have just opened a new 30,000 square foot photo-processing plant and photographic equipment store. The new plant, replacing a small existing facility, will greatly increase our capacity for handling the fast-growing volume of color and black-and-white film processing work provided by the photo departments at our stores.

Financial Activities

While we operate generally in leased locations, inventory and fixtures represent an investment of up to $250,000 for a new drug store and $1,000,000 for a junior department store.

Financial strength is essential to make such investments in long-range growth and maintain an active acquisition search at the same time. We have the necessary financial strength for substantial continuing expansion, both internally and through acquisitions.

Current assets of $37,027,082 as of June 30 were in a 2.4 ratio to current liabilities, providing working capital of $21,434,044. We have an $8,000,000 revolving bank credit agreement whereby all or any part of this amount can be converted into a six-year term loan in 1969.

New York Stock Exchange

Gray Drug had 4875 shareholders at the fiscal year-end, compared with 3969 a year ago. This indicates that the listing of our shares on the New York Stock Exchange, effective last January under the ticker symbol "GRY," has had the desired effect in broadening ownership of and interest in our Company. Our shares also continue to be listed on the Midwest Stock Exchange.

Dividend Increases

The quarterly dividend rate as adjusted for stock splits was increased to 20 cents a share with the payment made July 1, 1967, to 25 cents a share in January of 1968, and to the present 30 cents a share on April 1, 1968 or an indicated annual rate of $1.20 a share. There have been six dividend increases in the past 2½ years, and our present rate is about triple that of fiscal 1962. Gray Drug has now paid a cash dividend for 39 consecutive years.

Greater Depth of Management

Many younger men have been promoted into positions of increased responsibility during the past year, to provide back-up strength for our growth programs.

All drug operations have been consolidated at top management level under Marvin Kahn, vice president and a director, following the retirement of Henry H. Gray, who was vice president in charge of discount drug units, and Mr. Kahn has in turn promoted a number of younger men to key positions. For example, the manager of our conventional drug store operations is 33, the manager of our discount drug units 39, our manager of store display and merchandising 33, and our advertising manager 32.

Robert Breig, formerly treasurer, has been elected vice president in charge of data processing and control methods, a new position. Two other young men, one 40 and the other 37, both CPA's, have been promoted to treasurer and assistant treasurer respectively.

Our new electronic data processing center, equipped with our third generation of computers, is

playing an ever-increasing role in all of our operations. We have always emphasized the development of highly sophisticated computer programming, and this is highly beneficial in a business based on millions of small transactions a year.

Every store receives a complete monthly operating statement, for example, so that store managers and division managers have a complete and up-to-the-minute comparison of sales, expenses, and profit trends to guide them in achieving annual income goals.

Creative, experienced young management in depth is vital to the progress of a large retail organization. We have a talented, enthusiastic, substantial management team, and believe that it will continue to be a cornerstone of our growth.

Fiscal 1969 Outlook

In addition to the new stores and new operations scheduled for the current fiscal year, we generally expect increasing sales in nearly all of our existing stores, since these are largely located in suburban areas where consumer traffic continues to build year after year. Also, we have made two major acquisitions in four years, and will continue to seek new ones. Other growth programs are outlined elsewhere in this report.

Our stores can handle substantially increased sales with a relatively small build-up in overhead. This means that if consumer buying is strong, net income can rise more rapidly than sales, as illustrated by the improved profit margins of our drug divisions last year.

One of the largest remodeling programs in the history of our conventional drug store operations was carried out during the past year, to expand our cosmetic departments and improve front-of-the-store display. This involved 21 conventional drug stores, and much of the cost was reflected in operating expense.

The expense and effort involved for the newly acquired Bargain City Division and for our corporate staff in fitting this division into our over-all operations is largely behind us, and it is in a position to make a stronger profit contribution.

The Federal surtax, curtailment of Federal expenditures, increased Social Security taxes, and high interest rates may affect consumer spending and our own sales, and increasing wage rates, added taxes and other rising expenses are faced by all businesses, including our own.

However, to sum up, we anticipate considerable sales growth during the current year. Depending on consumer buying trends, which are strong to date in terms of most of the product lines we provide, the profit outlook also is favorable. On a long-range basis, we are in a better position than ever to maintain our traditional pattern of steady and profitable expansion.

Sincerely,

C. W. Evans,
Chairman

Jerome A. Weinberger,
President

September 27, 1968

Cosmetic volume is increasing steadily and substantially in our stores. 21 conventional drug stores were remodeled during the past year, and a major objective of this work was to upgrade and expand the cosmetic departments, one of which is shown above. Photo at right shows construction work on new 100,000 square foot Toledo junior department store, one of two new units soon to be opened by our Bargain City Division.

Operations and Planning Report

Gray Drug during recent years has developed a practical and clear-cut formula for growth in the big field of mass retailing, and this is working well to date.

Diversity is a key part of this formula . . . three different types of drug stores, entire department stores, and several types of leased departments in such stores, plus a photo processing business.

This broad base of operations enables us to take advantage of a number of strong current trends in mass retailing. In addition, it enables our various divisions to help each other grow.

For example, opening of a new Bargain City department store also creates a new leased prescription, health and beauty aids department for our King discount drug division, and leased soft goods departments for our Rink's Division. At the same time, the experience of these divisions adds competitive power and interest to the Bargain City store. Similarly, every store we open adds to our photo developing work.

Another characteristic of our growth formula is the building of maximum strength within a specific geographical region . . . generally in the expanding suburbs of Ohio's larger cities and adjacent areas of adjoining states. This gives us the benefit of continuing population increases to build store traffic. Regional concentration also is important in terms of close management control and operating economy.

Development of market leadership and a prestige image within the areas where our stores are concentrated is another common objective of all our divisions. We stress good service and maximum product quality . . . plus pleasant, attractive store decor that encourages women to stay longer, look around, and buy more.

Drug Divisions

Programs to increase sales per store and opening of six big prescription, health and beauty aids departments in our own department stores highlighted operation of our drug divisions during the past year.

Prescription work continued its long-range trend upward. Our more than 350 pharmacists filled over 4,500,000 prescriptions during the past year, representing a volume of over $15,000,000 or 8½ per cent more than the preceding year.

At the fiscal year-end, our drug divisions were operating 113 conventional drug stores and 62 discount units of various types.

Our conventional drug stores, operated by our Gray Division, are large stores, averaging about 9,000 square feet in size and offering about 25,000 different products per store. While prescriptions are important, the prescription department takes up a relatively small space in a big store, and our drug centers actually are variety stores of substantial size, featuring many of the nation's fastest-growing consumer lines.

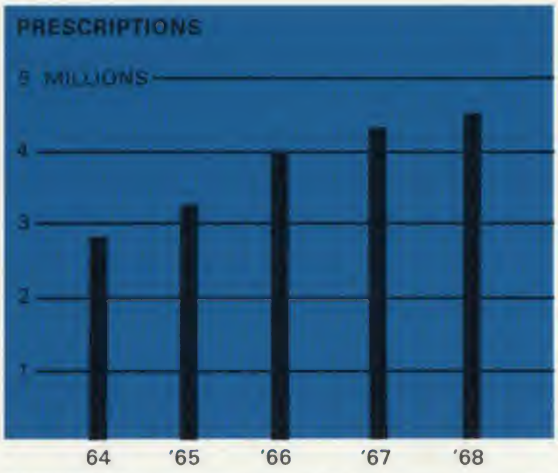
One of these is cosmetics, and increasing the size of cosmetic departments has been a principal goal in the unprecedented program of store remodeling we have undertaken during recent years . . . usually with an increase in sales of 10 to 25 per cent per store following remodeling.

Bigger-than-ever cosmetic departments are featured in the 21 stores remodeled during the past year. Our typical layout now makes certain that every woman, no matter what she comes into the store to buy, first passes through the cosmetic department. Well-trained cosmetic girls are on hand to advise her, and the world's best-known brand names are attractively displayed. We are constantly increasing emphasis on cosmetics and fragrances, which are excellent volume and profit builders, and will continue to do so.

Remodeling also has enabled us to feature other higher-ticket products, such as photo equipment, premium candy lines, and giftware. At the same time, our new standard store layout opens up the front of the store for better visual display and improves operating efficiency, through traffic controls that minimize manpower needs.

We remain very selective in terms of new drug store sites, largely limiting these to large regional shopping centers. The only openings by the Gray Division last year were a new store in Eastland Mall

Typical scenes at one of our 113 large and modern conventional drug stores.



The highest quality of prescription service possible to provide is the constant goal of our more than 350 pharmacists, who filled over 4,500,000 prescriptions last year.

at Columbus, and the replacement of an older store at Wooster.

However, we are opening at seven excellent new Ohio locations during the current fiscal year. A new store has just been opened at a shopping center in Warren, and a pharmacy has been opened in the new Severance Medical Arts Building in Cleveland. Stores will be opened during the year at other large shopping centers in Fremont, Warren, Marion, and Columbus, along with a store in a large new downtown development at Cincinnati.

The combined effect of the past year's remodeling work and this year's new stores should make fiscal 1969 another record-breaking sales year for the Gray Division.

Our King Division operates three types of units. These include 21 high-volume prescription, health and beauty aids, and photography departments in the stores of other retailers. It operates another 18 leased departments in our own Rink's and Bargain City department stores.

King has a number of free-standing discount drug stores, smaller than our conventional drug centers, but still a worthwhile source of sales and income, and also operates prescription stores.

The King Division opened eight units during the past fiscal year, including six leased departments in Rink's and Bargain City stores, and it closed six older units. All of its six new locations for the current year are leased departments in discount department stores. Negotiations on a number of other openings are under way.

Department Store Divisions

The 100,000 square foot store opened by Rink's at Middletown, Ohio, in June of 1967 was highly successful during its first year, and so was the Mt. Healthy store of the same size opened in the Cincinnati area during fiscal 1968. These new units were responsible for the division's record sales. Total volume at other stores was down during the first half of the fiscal year, when other retailers opened a large number of stores in the Cincinnati area, but has been gaining during recent months.

Product lines have been upgraded, particularly in women's wear. Sports goods departments have been enlarged. Profit control systems of the type developed for our drug divisions have been introduced, under a new executive with long experience at our Cleveland headquarters, and new merchandise managers have been added.

Rink's, with nine stores today compared with four when we acquired this chain in 1964, is a leading retailer in the fast-growing Cincinnati area. In addition to the Evendale store remodeling and the remodeling and enlarging of the Milford store, we are actively seeking new store locations.

A specialist in soft goods, Rink's also had a busy year in setting up men's and women's apparel de-

Typical views of the large prescription, health and beauty aids and photography centers we operate in our own discount department stores and in stores of other retailers.

partments which it originated or bought out in Bargain City Division stores. This program adds to Rink's profit potential, and will be continued.

Bargain City, with 13 stores, has established a foundation for large-scale growth. Its Findlay store, opened last year, has been building up sales momentum, and fiscal 1969 will be its first full year of operation. The new 100,000 square foot store on Woodville Road in Toledo will open next month, and a new store of similar size will be open at Marion, Ohio, in time for the holiday season. Both units replace existing small stores.

This division in entering the appliance business directly for the first time, plans a rapid build-up in this field, which should add substantially to Bargain City sales on a full-year basis.

In another new move, Bargain City is building large service station, tire, battery and accessory centers at two of its stores. These automotive centers represent an entirely new type of unit for us. They will be separate buildings adjacent to the main stores. They will be operated through an arrangement with the Firestone Co. which we believe is the first of its type and which will enable Bargain City to offer a complete package of first-line Firestone tires, batteries and accessory units.

If these TBA centers work out well, we will add similar units at other Rink's and Bargain City stores. Most of these stores now include large leased supermarkets, so that the addition of large automotive centers adjacent to 50-department discount stores will provide real one-stop shopping convenience.

Many Roads to Growth

As these examples indicate, Gray Drug is growing in many ways, and constantly seeking new sources of sales and profits. Our various divisions already are providing substantial revenue for one another, and we expect this trend to develop further.

While necessities and products basic to a normal standard of living in any economic weather provide a good measure of stability in our business, we obviously benefit from a high level of consumer buying.

Our drug divisions currently are enjoying very favorable profit trends. Also, general retail volume in our service area has been increasing to date during the current fiscal year, and this is reflected in our junior department store volume.

We believe that consumers will be quite value-conscious during the months ahead, with prices generally going up and taxes biting more deeply. Since providing maximum value in terms of quality and price is our business, present conditions favor our type of high-volume, competitive merchandising. In addition, any improvement in residential building would quickly be translated into higher sales for many of the departments in our junior department stores.

The 22 junior department stores operated by our Rink's and Bargain City divisions are attractive and spacious, with some 50 departments each. Typical departments in these stores are shown in these photos.

Our junior department stores accounted for over $45,166,000 in sales last year, with an additional $52,837,000 in volume generated by leased departments in these stores, including food supermarkets.

CONSOLIDATED BALANCE SHEET Gray Drug Stores, Inc. and Subsidiaries

	June 30, 1968	June 30, 1967
ASSETS		
CURRENT ASSETS		
Cash	$ 4,272,638	$ 2,859,268
Accounts receivable, less allowance of $30,000	1,233,568	822,562
Inventories — priced generally on the basis of the lower of cost (latest) or replacement market	31,012,889	22,371,309
Prepaid expenses	507,987	458,353
TOTAL CURRENT ASSETS	$37,027,082	$26,511,492
OTHER ASSETS	473,479	277,544
PROPERTY AND EQUIPMENT — on the basis of cost		
Land (1968 — $163,347; 1967 — $161,102) and buildings	$ 235,919	$ 233,675
Furniture, fixtures and equipment	7,288,165	6,184,187
Leasehold improvements	3,515,386	2,676,886
	$11,039,470	$ 9,094,748
Less allowance for depreciation and amortization	4,733,178	3,911,294
	$ 6,306,292	$ 5,183,454
GOOD WILL — Note A	3,758,997	1,561,227
	$47,565,850	$33,533,717

NOTES TO FINANCIAL STATEMENTS

NOTE A — ACQUISITIONS AND GOOD WILL

As of July 1, 1967, the Company purchased all of the outstanding capital stock of Washington Distributors, Inc. and affiliated companies for the sum of (1) 30,000 shares of Common Stock issued at $25 a share, (2) $3,684,302 of which $888,226 remains to be paid in equal annual installments through June 30, 1971, and (3) additional payments to be based on the annual combined net income (as defined) of the acquired companies through June 30, 1971. The accounts of these companies have been included in the consolidated financial statements since date of acquisition.

Goodwill at June 30, 1968, represents the excess of cost of investment in purchased companies over their recorded net assets at acquisition dates. Because there has been no diminution in the value attributable to good will, the Company does not now intend to amortize such amount.

NOTE B — LONG-TERM DEBT

On July 1, 1967, the Company executed a revolving credit agreement with a bank under which it may borrow up to $8,000,000. Interim borrowings thereunder bear interest at the prime commercial rate from time to time in effect and mature on August 1, 1969, when they may be converted into a term loan payable over a six-year period beginning September 30, 1969, with interest at the prime commercial rate prevailing at the conversion date plus ¼%. The terms of the agreement include covenants covering maintenance of working capital and limiting payment of cash dividends and other capital distributions (as de-

LIABILITIES AND SHAREHOLDERS' EQUITY	June 30, 1968	June 30, 1967
CURRENT LIABILITIES		
Trade accounts	$ 8,561,282	$ 6,096,564
Other liabilities and accrued expenses	3,151,277	2,211,228
Taxes other than federal income taxes	783,951	636,103
Federal income taxes	2,800,453	2,490,387
Current portion of long-term debt	296,075	—0—
TOTAL CURRENT LIABILITIES	$15,593,038	$11,434,282
LONG-TERM DEBT — Note B		
Notes payable to bank — due August 1, 1969	$ 6,000,000	$ —0—
Payable under acquisition agreement — less current portion	592,151	—0—
	$ 6,592,151	$ —0—
SHAREHOLDERS' EQUITY		
Common Stock, par value $1 a share:		
Authorized 2,000,000 shares		
Outstanding 1,662,540 shares (1967 — 1,300,032 shares)	$ 1,662,540	$ 1,300,032
Capital in excess of par value	9,207,297	8,819,805
Earnings retained for use in the business — Note B	14,510,824	11,979,598
	$25,380,661	$22,099,435
LONG-TERM LEASE COMMITMENTS — Note C		
	$47,565,850	$33,533,717

See notes to financial statements.

fined). Under the more restrictive of these covenants, earnings retained for use in the business of approximately $4,031,000 were available at June 30, 1968, for distribution to shareholders.

The amount payable under acquisition agreement represents the unpaid balance of that portion of the purchase price of Washington Distributors, Inc. and affiliated companies which is based on their book value (as defined) at date of acquisition, and is payable in annual installments of $296,075 through June 30, 1971, with interest at the prime commercial rate from time to time in effect.

NOTE C — LONG-TERM LEASE COMMITMENTS

The Company and its subsidiaries are lessees under a number of leases extending from one to twenty-four years. The annual aggregate minimum rental payable under such leases (many of which provide for additional rental if amounts based on specific percentages of sales exceed the minimum) amounted to approximately $4,540,000 at June 30, 1968.

NOTE D — PENSION PLANS

The Company and its subsidiaries have two noncontributory pension plans covering certain of their employees. Total pension expense for the year ended June 30, 1968, was approximately $350,000 including amortization of past service costs to the retirement age of participants. The Company's policy is to fund pension cost accrued.

STATEMENT OF CONSOLIDATED INCOME AND EARNINGS RETAINED FOR USE IN THE BUSINESS

Gray Drug Stores, Inc. and Subsidiaries

	Year Ended June 30, 1968	1967
Net sales	$124,899,300	$ 93,598,735
Rent from leased departments	1,880,780	501,355*
Other income	327,262	380,647
	$127,107,342	$ 94,480,737
Costs and expenses:		
Cost of goods sold	$ 83,665,555	$ 62,192,310
Selling, general, and administrative expenses	34,081,730	25,129,755
Depreciation and amortization	1,166,604	982,297
Interest expense	494,887	88,581
	$119,408,776	$ 88,392,943
INCOME BEFORE FEDERAL INCOME TAXES	$ 7,698,566	$ 6,087,794
Federal income taxes	3,504,800	2,830,900
NET INCOME	$ 4,193,766	$ 3,256,894
Earnings retained for use in the business at beginning of year	11,979,598	9,925,254
	$ 16,173,364	$ 13,182,148
Cash dividends declared	1,662,540	1,202,550
EARNINGS RETAINED FOR USE IN THE BUSINESS AT END OF YEAR	$ 14,510,824	$ 11,979,598
Per share of Common Stock (1967 amounts adjusted for the five-for-four stock split in 1968):		
Net income	$ 2.52	$ 2.01
Cash dividends declared	1.00	.74

*Reclassified from selling, general, and administrative expenses to conform to 1968 classifications.

See notes to financial statements.

STATEMENT OF CONSOLIDATED SOURCE AND APPLICATION OF FUNDS

Gray Drug Stores, Inc. and Subsidiaries

	Year Ended June 30, 1968	1967
SOURCE OF FUNDS		
From operations:		
Net income	$ 4,193,766	$ 3,256,894
Depreciation and amortization which did not affect working capital	1,166,604	982,297
TOTAL FROM OPERATIONS	$ 5,360,370	$ 4,239,191
Proceeds from bank borrowings	6,000,000	—0—
Long-term portion of amount payable under acquisition agreement	592,151	—0—
Fair market value of Common Stock issued in connection with companies purchased	750,000	—0—
	$ 12,702,521	$ 4,239,191
APPLICATION OF FUNDS		
Expenditures for property and equipment	$ 1,652,467	$ 1,392,668
Net carrying amount of property and equipment of purchased companies at acquisition date	636,975	—0—
Good will purchased	2,197,770	369,235
Cash dividends declared	1,662,540	1,202,550
Increase in other assets and miscellaneous	195,935	(16,104)
Added to working capital	6,356,834	1,290,842
	$ 12,702,521	$ 4,239,191

See notes to financial statements.

STATEMENT OF CONSOLIDATED CAPITAL IN EXCESS OF PAR VALUE

Gray Drug Stores, Inc. and Subsidiaries

	Year Ended June 30, 1968	Year Ended June 30, 1967
Balance at beginning of year	$8,819,805	$9,253,149
Excess of fair market value over aggregate par value of 30,000 shares of Common Stock issued in connection with the acquisition of Washington Distributors, Inc. and affiliated companies	720,000	—0—
	$9,539,805	$9,253,149
Par value of 433,344 shares of Common Stock issued to effect a three-for-two stock split	—0—	433,344
Par value of 332,508 shares of Common Stock issued to effect a five-for-four stock split	332,508	—0—
Balance at end of year	$9,207,297	$8,819,805

See notes to financial statements.

ACCOUNTANT'S REPORT

Board of Directors
Gray Drug Stores, Inc.
Cleveland, Ohio

We have examined the consolidated balance sheet of Gray Drug Stores, Inc. and subsidiaries as of June 30, 1968, and the related statements of consolidated income and earnings retained for use in the business, consolidated capital in excess of par value, and consolidated source and application of funds for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We previously made a similar examination of the financial statements for the preceding year.

In our opinion, the accompanying statements identified above present fairly the consolidated financial position of Gray Drug Stores, Inc. and subsidiaries at June 30, 1968, and the consolidated results of their operations and consolidated source and application of funds for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Cleveland, Ohio
August 28, 1968

Ernst, Ernst

10 years of Progress

	1968	1967	1966	1965	1964	1963	1962	1961	1960	1959
Net Sales	$124,899,300	$93,598,735	$83,352,705	$73,570,697	$57,320,337	$51,875,334	$44,952,417	$39,626,661	$37,552,700	$35,991,537
Net Income Before Federal Taxes on Income	$ 7,698,566	$ 6,087,794	$ 5,581,032	$ 4,337,653	$ 2,011,104	$ 1,399,066	$ 1,611,213	$ 1,467,793	$ 1,673,989	$ 1,607,591
Net Income	$ 4,193,766	$ 3,256,894	$ 2,912,432	$ 2,176,053	$ 946,404	$ 662,366	$ 801,113	$ 707,793	$ 793,989	$ 768,591
Income per Common Share (1)	$ 2.52	$ 2.01	$ 1.79	$ 1.72	$ .80	$ .56	$ .68	$ .76	$ .87	$ .84
Income as a Percentage of Sales	3.36%	3.48%	3.49%	2.96%	1.65%	1.28%	1.78%	1.78%	2.12%	2.14%
Income as a Percentage of Shareholders Equity	16.52%	14.73%	14.53%	16.55%	8.78%	6.41%	7.87%	9.04%	10.82%	11.20%
Cash Dividends Declared —Common Stock	$ 1,662,540	$ 1,202,550	$ 858,805	$ 568,641	$ 503,723	$ 503,723	$ 476,335	$ 393,062	$ 323,850	$ 256,720
Dividends Per Share (1)	$ 1.00	$ .74	$ .59	$ .45	$ .43	.43	.43	.43	.36	.28
Number of Shares Issued (1)	1,662,540	1,625,040	1,625,040	1,266,664	1,180,601	1,180,601	1,180,601	931,429	910,829	910,829
Net Working Capital	$ 21,434,044	$15,077,210	$13,786,368	$12,431,574	$12,132,632	$11,692,984	$11,599,620	$ 6,218,365	$ 6,087,245	$ 5,630,703
Total Assets	$ 47,565,850	$33,533,717	$31,711,280	$28,532,091	$22,764,138	$21,203,745	$20,296,698	$14,195,991	$14,114,536	$13,262,079
Long Term Debt	$ 6,592,151	—	—	$ 5,141,300	$ 5,141,300	$ 5,230,000	$ 5,230,000	$ 2,139,200	$ 2,313,500	$ 2,313,500
Shareholders Equity	$ 25,380,661	$22,099,435	$20,045,091	$13,144,946	$10,783,652	$10,340,971	$10,182,328	$ 7,826,699	$ 7,338,099	$ 6,867,960
Book Value Per Share (1)	$ 15.27	$ 13.60	$ 12.34	$ 10.38	$ 9.13	$ 8.76	$ 8.62	$ 8.40	$ 8.06	$ 7.54
Fixture and Leasehold Additions	$ 1,661,586	$ 1,465,563	$ 1,141,939	$ 1,184,347	$ 813,084	$ 923,337	$ 713,221	$ 901,411	$ 748,758	$ 985,427
Depreciation	$ 1,166,604	$ 982,297	$ 967,289	$ 869,409	$ 731,322	$ 758,985	$ 667,295	$ 663,750	$ 633,483	$ 575,139
Units in Operation— End of Year	203	187	173	158	151	152	134	117	111	107

(1) Based upon the number of shares outstanding at the end of each year adjusted to reflect a stock split of 3 for 1 on September 30, 1960, a 3 for 2 stock split on September 30, 1966, and a 5 for 4 stock split on November 6, 1967.

BOARD OF DIRECTORS

L. C. DOUGLASS
Vice-President
Gray Drug Stores, Inc.

HERBERT H. DURR
Vice-President
Gray Drug Stores, Inc.

C. W. EVANS
Chairman and Chief
Operating Executive
Gray Drug Stores, Inc.

MARVIN L. KAHN
Vice-President
Gray Drug Stores, Inc.

C. BERT McDONALD
Managing Partner
McDonald & Company

JOHN W. REAVIS
Managing Partner, Jones, Day,
Cockley & Reavis

HYMAN R. SWOLSKY
President
Washington Distributors, Inc.
(Bargain City Division)

ADOLPH WEINBERGER
Chairman of the Executive
Committee and Chief Executive
Gray Drug Stores, Inc.

CARL WEINBERGER
Buyer
Gray Drug Stores, Inc.

JEROME A. WEINBERGER
President
Gray Drug Stores, Inc.

OFFICERS

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Chairman of the Executive
Committee and Chief Executive

C. W. EVANS
Chairman and Chief
Operating Executive

JEROME A. WEINBERGER
President

L. C. DOUGLASS
Vice-President

HERBERT H. DURR
Vice-President

MARVIN L. KAHN
Vice-President

LOUIS BERWITT
Vice-President and Secretary

ROBERT E. BREIG
Vice-President

KENNETH FREY
Treasurer

ALBERT F. HANZLICK
Assistant Treasurer

JOSEPH VALINS
Assistant Secretary

HERBERT IVES
Vice-President
Rink's Department Stores, Inc.

HYMAN R. SWOLSKY
President
Washington Distributors, Inc.
(Bargain City Division)

TRANSFER AGENT AND REGISTRAR

The Cleveland Trust Company
Cleveland, Ohio

AUDITORS

Ernst & Ernst
Cleveland, Ohio

STOCK LISTED

New York Stock Exchange
Midwest Stock Exchange

COUNSEL

Jones, Day, Cockley and Reavis
Cleveland, Ohio

MAIN OFFICE

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Cleveland, Ohio 44114

WAREHOUSE

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Cleveland, Ohio 44114

RINK'S DIVISION HEADQUARTERS

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Cincinnati, Ohio 45246

BARGAIN CITY DIVISION HEADQUARTERS

1225 Indiana Avenue
Toledo, Ohio

GRAY

GRAY DRUG STORES, INC., 666 EUCLID AVENUE, CLEVELAND, OHIO 44114